

**DEPARTMENT OF MOTOR VEHICLES  
RICHMOND, VIRGINIA**

**REPORT ON AUDIT  
FOR THE YEAR ENDED  
JUNE 30, 2003**



## **AUDIT SUMMARY**

### **CURRENT FISCAL OPERATIONS**

#### **Cash Flow**

As reported in prior audit reports, Motor Vehicles continues to experience cash flow difficulties, which required management to request and receive a Treasury Loan of \$6 million for the fiscal year ended June 30, 2003. Additionally, management is projecting that Motor Vehicles will need to increase this loan to \$7.5 million to meet its obligations by the close of fiscal year 2004.

#### **Controlling Costs**

Historically, Motor Vehicles requests and receives additional appropriations when fees collected exceed forecasted amounts. However, due to the budgetary issues throughout the Commonwealth, Motor Vehicles was required to reduce their operating budget for fiscal year 2003 and transfer the anticipated savings to the General Fund of the Commonwealth. Motor Vehicles did not achieve the required savings and therefore, needed the Treasury Loan noted above meet their obligations.

Fundamental to controlling costs is having a mechanism to set the cost of the level of service and performance the Governor and General Assembly expect of Motor Vehicles. This expectation deals not only with cost and service, but also considers and includes productivity measures. Until such guidance is available to Motor Vehicles, the solution to the Department's cash flow problems will continue to appear only in terms of closed offices and longer lines.

### **GENERAL AUDIT SUMMARY**

Our audit of the Department of Motor Vehicles for the year ended June 30, 2003, found:

- an internal control matter that we consider a reportable condition;
- no instances of noncompliance with laws and regulations tested required to be reported under Government Auditing Standards;
- proper recording and reporting of transactions, in all material respects, in the Commonwealth Accounting and Reporting System; and
- adequate corrective action of prior audit findings, except for the prior year finding titled "Assess Needs and Develop Policy and Procedures over the Fuels Tax Program."

- TABLE OF CONTENTS -

AUDIT SUMMARY

CURRENT FISCAL OPERATIONS

FUTURE BUDGET ISSUES

FISCAL YEAR 2003

ANALYSIS OF 2003 EXPENSES

REVENUE AND COST ANALYSIS

FUELS TAX PROGRAM

INTERNAL CONTROL FINDINGS AND RECOMMENDATIONS

INDEPENDENT AUDITOR'S REPORT

AGENCY RESPONSE

AGENCY OFFICIALS

## **CURRENT FISCAL OPERATIONS**

As reported in prior audit reports, the Department of Motor Vehicles (Motor Vehicles) continues to experience cash flow difficulties, which required management to request and receive a Treasury Loan of \$6 million for the fiscal year ended June 30, 2003. Additionally, management is projecting that Motor Vehicles will need to increase this loan to \$7.5 million to meet its obligations by the close of fiscal year 2004.

## **FUTURE BUDGET ISSUES**

For fiscal year 2004, the Appropriation Act provided Motor Vehicles with an appropriation of \$196.7 million for operating expenses. Motor Vehicles has an internal spending plan of \$214.6 million. In addition to these operating expenses Motor Vehicles has required mortgage and revenue anticipation loan payments of \$3.3 million and \$6 million, respectively. As discussed later, Motor Vehicles anticipates receiving authority to spend additional revenue collections. At this level of spending, if Motor Vehicles does not receive authority to spend additional revenue collections, its operating cash requirements will exceed their current operating appropriations by \$27 million.

The Appropriation Act also requires Motor Vehicles to transfer revenue to the General Fund of the Commonwealth. These transfers are payments for various services or mandated reductions and savings. In fiscal year 2004, Motor Vehicles will need to transfer approximately \$19 million of revenues collected to the General Fund (see Table 1).

Table 1

### Appropriation Act Part 3 Transfers \*

Central agency cost recovery	\$ 958,258
COVAnet (DIT Telecom savings)	272,487
Retiree health credit	229,944
Group insurance suspension savings	580,975
VSDP rate reduction	169,789
IRIS cost recovery	49,232
VRS rate reduction savings	455,400
Information product fees	10,000,000
Governor's budget reduction	<u>6,615,437</u>
Total transfers	<u><u>\$19,331,522</u></u>

\* Summary of information for the Chapter 1042 of the 2003 Virginia Acts of the Assembly

As illustrated in Table 2, Motor Vehicles plans on submitting a request for approval to spend additional revenues collected to meet the anticipated operating plan requirements. Motor Vehicles anticipates an additional \$14 million in operating fund revenues due primarily to increased product fees and an additional \$3.6 million in revenues from federal funds. However, the appropriation of additional funding is subject to the approval of the Department of Planning and Budget and, potentially, the General Assembly's appropriation process.

Table 2

	<u>Chapter 1042 Appropriations</u>	<u>Anticipated Funding Increase</u>	<u>2004 Target Operating Level</u>
Highway Maintenance and Operating Fund	\$ 9,903,828	\$ -	\$ 9,903,828
Motorcycle Safety Fund	379,600	500,000	879,600
Drive Smart Fund	-	20,000	20,000
Special Operating Fund	131,999,577	13,907,935	145,907,512
Motor Carrier Special Fund	3,719,003	(1,219,003)	2,500,000
Parking Fund	-	80,000	80,000
Surplus Property Fund	-	80,000	80,000
Uninsured Motorist Fund	4,523,111	923,489	5,446,600
Rental Vehicle Fund	32,000,000	-	32,000,000
Mobile Home Fund	10,440,000	-	10,440,000
Federal Trust Fund	<u>3,773,734</u>	<u>3,615,266</u>	<u>7,389,000</u>
Total	<u>\$196,738,853</u>	<u>\$17,907,687</u>	<u>214,646,540</u>
Additional transfers due in fiscal year 2004 outside of the Appropriation Act:			
2003 Revenue Anticipation Loan			6,000,000
Mortgage payment			<u>3,296,982</u>
Total anticipated operating budget			<u>\$223,943,522</u>

As shown below in Table 3, in addition to the anticipated operating budget Motor Vehicles requires resources to make the mandatory transfers of \$19.3 million. Table 4 shows the forecasted revenue available to Motor Vehicles from various sources including beginning cash balance and how management calculated the need for the Treasury loan discussed earlier in this report.

Table 3

Total resources required:	
2004 anticipated operating budget	\$223,943,522
2004 mandatory transfers	19,331,522
2004 capital outlay budget	<u>500,000</u>
Total resources required	<u>\$243,775,044</u>

Table 4

Total resources available:	
Beginning cash balance	\$ 1,471,037
Legal presence additional appropriations	1,000,000
Forecasted revenue by fund:	
Highway Maintenance and Operating	9,903,828
Motorcycle Safety	879,600
Drive Smart	20,000
Special Operating	162,109,800
Motor Carrier Special	2,500,000
Parking	80,000
Surplus Property	80,000
Uninsured Motorist	5,446,600
Rental Vehicle	32,000,000
Mobile Home	10,440,000
Federal Trust	<u>7,389,000</u>
Total forecasted revenue by fund	<u>233,319,865</u>
VDOT transfers:	
Legal presence additional appropriations	1,500,000
Fuels tax reimbursement	<u>1,500,000</u>
Total resources available	<u>\$236,319,865</u>
 Total resources required	 \$243,775,044
Total resources available	<u>236,319,865</u>
 Planned treasury loan	 <u>\$ 7,455,179</u>

**FISCAL YEAR 2003**

Historically, Motor Vehicles requests and receives additional appropriations when fees collected exceed forecasted amounts. Many special revenue agencies follow this funding practice. However, due to the budgetary issues throughout the Commonwealth, Motor Vehicles was required to reduce their operating budget for fiscal year 2003 and transfer the anticipated savings to the General Fund of the Commonwealth.

To achieve these reductions, Motor Vehicles closed 12 customer service centers and reduced their operating hours. During the spring of 2003, the Governor and General Assembly reversed these decisions and Motor Vehicles reopened the 12 branch offices and restored normal business hours. Because there has been no guidance on the level of customer service, Motor Vehicles management continues to focus on a high level of customer service and not on controlling costs.

Fundamental to controlling costs is having a mechanism to set the cost of the level of service and performance the Governor and General Assembly expect of Motor Vehicles. This expectation deals not only with cost and service, but also considers and includes productivity measures. Until such guidance is available to Motor Vehicles, the solution to the department's cash flow problems will continue to appear only in terms of closed offices and longer lines.

## ANALYSIS OF 2003 EXPENSES

Motor Vehicles currently administers eight programs. Motor Vehicles management has significant budgetary control of four of these programs, the other four programs are either the collection and distribution of taxes or federal funds to localities and other state agencies. As shown in Table 5, Motor Vehicles achieved approximately \$17 million in savings during fiscal year 2003 compared to expenses of the previous two fiscal years. The Highway Vehicle Regulation Program generated the majority of these savings while other programs remained unaffected.

Table 5

### Analysis of Expenses by Program Fiscal Year Ended June 30, 2003

<u>Program Name</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>Amount of Change from 2002-2003</u>	<u>Percent of Change</u>
Financial Assistance to Localities for					
Disposal of Vehicles	\$ 431,450	\$ 449,900	\$ 404,790	\$ ( 45,110)	-10.03%
Highway Vehicle Regulation	130,205,636	134,696,124	117,353,427	(17,342,697)	-12.88%
Ground Transportation Safety					
Promotion	7,543,023	9,498,461	8,084,507	(1,413,954)	-14.89%
Financial Assistance for					
Transportation Safety	2,140,029	1,929,259	2,104,008	174,749	9.06%
General Management and Direction	26,075,689	29,440,132	29,584,311	144,179	0.49%
Physical Plant Services	9,976,249	5,432,257	6,597,970	1,165,713	21.46%
Distribution of Mobile Home Taxes	11,111,512	8,294,129	7,299,013	(995,116)	-12.00%
Distribution of Rental Vehicle Taxes	28,028,842	25,868,327	27,178,834	1,310,507	5.07%
Capital Outlay	<u>484,812</u>	<u>286,303</u>	<u>429,896</u>	<u>143,593</u>	50.15%
 Total expenses	 <u>\$215,999,242</u>	 <u>\$215,894,892</u>	 <u>\$199,036,756</u>	 <u>\$(16,858,136)</u>	

The Highway Vehicle Regulation Program focuses on customer service operations. This program has responsibility to title, train, test, and license vehicles and drivers using the highway system; to identify businesses permitted to sell vehicles according to specified conditions; and to regulate rates and routes for the transportation of persons and goods. As Table 6 illustrates, Motor Vehicles' management realized significant savings in this program by reducing personal and contractual services, as well as supplies and materials.

Table 6

Analysis of Expenses by Category Highway Vehicle Regulation

<u>Expense Category</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>Amount of Change from 2002-2003</u>
Personal services	\$ 74,488,459	\$ 76,236,933	\$ 68,024,834	\$( 8,212,099)
Contractual services	30,465,664	32,957,417	26,291,202	(6,666,215)
Supplies and materials	11,341,343	13,497,525	10,906,640	(2,590,885)
Transfer payments	90,961	60,253	464,317	404,064
Continuous charges	10,305,060	10,039,922	11,139,066	1,099,144
Property and improvements	92,281	23,288	85,111	61,823
Equipment	3,288,250	1,771,230	317,560	(1,453,670)
Plant and improvements	<u>133,619</u>	<u>109,556</u>	<u>124,697</u>	<u>15,141</u>
Total expenses	<u>\$130,205,637</u>	<u>\$134,696,124</u>	<u>\$117,353,427</u>	<u>\$(17,342,697)</u>

However, there was no significant savings in the General Management and Direction Program. This program provides administrative management for the agency and includes many overhead functions including the Financial Management Services, the Commissioners Office, and part of Information Technology Services.

Table 7

Analysis of Expenses by Category General Management and Direction

<u>Expense Category</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>Amount of Change from 2002-2003</u>
Personal services	\$21,634,409	\$21,249,821	\$20,568,722	\$( 681,099)
Contractual services	2,181,747	5,171,961	6,385,988	1,214,027
Supplies and materials	63,649	76,469	544,387	467,918
Transfer payments	7,888	18,025	46,714	28,689
Continuous charges	1,373,624	1,786,039	1,848,635	62,596
Equipment	<u>814,372</u>	<u>1,137,816</u>	<u>189,866</u>	<u>(947,950)</u>
Total expenses	<u>\$26,075,689</u>	<u>\$29,440,131</u>	<u>\$29,584,312</u>	<u>\$ 144,181</u>

### **REVENUE AND COST ANALYSIS**

Our November 14, 2003 report titled, "Department of Motor Vehicles Cost Analysis Special Report," included an extensive discussion of fiscal year 2003 revenue and costs. In this report, we compared the true cost of Motor Vehicles' services and activities to the fees, penalties, and other sources of revenue available to the agency. We also determined all funding resources, their uses and restrictions, and the reasonableness of revenue allocation processes for all operating funds. There is also a discussion on Motor Vehicles' cash management activities and its relationship to forecasting and budgeting. To avoid duplication of effort, we refer the reader to Chapters 3, 4, and 9 of this report. The reader can access the report at [http://www.apa.state.va.us/reports/audit\\_and\\_special\\_reports.htm](http://www.apa.state.va.us/reports/audit_and_special_reports.htm).



## **FUELS TAX PROGRAM**

Effective January 1, 2001, the Virginia Fuels Tax Act changed the timing and reporting of fuels tax collections within the Commonwealth. The tax collection point moved from the distributor level to the terminal rack, referred to as "Tax at the Rack."

Motor fuel comes into the Commonwealth by various methods (trucks, ships, underground pipes, etc.) and is unloaded at a terminal. There are many terminals throughout the Commonwealth. At the terminal, the rack dispenses fuel. The fuel at a terminal can have many owners (suppliers). A supplier sells the fuel from the rack and is responsible for collecting and remitting the tax on the fuel purchased to Motor Vehicles on the 20<sup>th</sup> of the second month following the date of purchase. The supplier sells the fuel to distributors. At that point, the supplier charges and collects the tax paid to Motor Vehicles from the distributors. Both suppliers and distributors submit detailed reports on each sale as to the seller or purchaser and the number of gallons purchased or sold. By taxing at the terminal, the number of tax remitters went from 1,300 to approximately 350.

Fuel can move by different methods. Motor Vehicles is due the fuel taxes when one of the following occurs to the fuel:

- Removal from a refinery or a terminal and is subject to the federal excise tax imposed.
- Imported by a system transfer to a refinery or a terminal and, upon importation, is subject to the federal excise tax imposed.
- Imported by a means for transfer outside the terminal transfer system for sale, use, or storage in Virginia and would have been subject to the federal excise tax imposed, if the removal at a terminal or bulk plant rack in Virginia instead of being imported.
- Blended fuel made within Virginia or imported into Virginia.
- Transferred within the terminal transfer system and, upon transfer, is subject to the federal excise tax imposed.

The new legislation required Motor Vehicles to license and re-license customers and train licensees and staff, in addition to creating license applications, bond forms, and tax forms. The legislation reduced the number of tax reporters, but increased the number of licensee classifications and information reporters. Licensees submit a tax report or informational report to the Commonwealth on the 20<sup>th</sup> day of the second month following the date of fuel activity. All reports require detailed schedule information such as product information, mode of transportation, carrier and seller names, identification numbers, gallons sold and purchased, and date shipped or received.

Licensees can submit these reports either manually or electronically. Motor Vehicles was not able to stay current with the volume of tax reports and contracted with an outside vendor to assist with report entry. The new legislation also required significant system changes. Rather than change the old fuels tax system, Motor Vehicles implemented a new automated fuel tracking system. Motor Vehicles contracted with Affiliated Computer Services to provide a system that included two components. One component, Motor Fuel Tracking, tracks fuel gallons by load; the other, VISTA/TS, tracks license data and revenue.

This new system should allow Motor Vehicles to track fuel deliveries and related financial information. The tracking system produces a crosscheck report that allows Motor Vehicles to ensure the records are complete and accurate. This system should enable Motor Vehicles to pursue revenue owed from those that do not file reports timely or submit sufficient payment for their activity.

Prior to the change in fuels tax legislation, Motor Vehicles collected \$764 million in 1999 and \$777 million in 2000. After the implementation of this new legislation, Motor Vehicles collected over \$804 million in 2001, \$807 million in 2002, and \$823 million in 2003.

Since the implementation of the legislation Motor Vehicles has experienced problems in the processing and reporting of fuels tax information. In January 2003, Motor Vehicles still had unprocessed tax schedules that dated back to January 2001. Motor Vehicles' management decided that entering the detailed schedules into the Fuels Tax System was not cost effective and, therefore, decided not to process detail reports prior to January 2003. This decision has allowed Motor Vehicles to keep up with the current reports; however, fuels tax processes and controls are still not operating efficiently.

Our review of the system indicates there are internal control weaknesses with the program. The following section discusses several internal control issues and recommendations we have previously reported, but are still present.

## **INTERNAL CONTROL FINDINGS AND RECOMMENDATIONS**

### **Assess Needs and Develop Policies and Procedures over the Fuels Tax Program**

With the change to "Tax at the Rack," Motor Vehicles implemented a new automated system, the Motor Fuels Tracking System (MFTS) to track the collection and reporting of motor fuels tax. We reviewed MFTS's processes and the critical automated and manual internal control components over the system. Our review identified several important issues noted below that could adversely affect the tax collection and reporting processes.

1. The new system is a shared computer system that a number of other states use. The use of an existing shared system reduces and eliminates the cost to Motor Vehicles of having to design and develop a new independent system. However, like most modern systems, this approach requires the users to change how they process transactions and perform their work. Motor Vehicles' staff has not fully adopted new processing procedures to conform to the system.

Adopting new processing procedures and expanding the use of the system automated process such as accepting electronic tax filing will reduce the number of errors, speed processing, and increase accuracy. As an example, tests of the electronic filing process has reduced errors and increased the accuracy of filer information.

2. Motor Vehicles does not have formal policies and procedures addressing transaction processing on the new system by employees within the Fuels Tax Division. Policies and procedures should provide essential information for user reference, efficiency of operations, and general knowledge over the system.
3. The new system does not provide reliable reports containing information relating to accounts receivable, non-filers, and discrepancies. Motor Vehicles has requested system changes to provide information relating to accounts receivable. Personnel continue to manually process non-filers reports, since they cannot rely on the automated report.

4. Motor Vehicles' Tax Division is using extensive manual processes to obtain important tax information. These manual processes cause inefficient use of time and increase the possibility of errors in reporting. Manual processes include identifying non-filers of tax reports, preparing bills for outstanding payments due, issuing refunds for overpayments, and providing statistical data for reports and letters forwarded to internal and external customers. System capabilities include each of these processes.

Taxpayers can submit their informational reports on paper or electronically. Beginning June 30, 2003 suppliers, terminal operators, and importers are required to file reports electronically. Electronic submission of all other reports will be mandatory beginning in 2005. Motor Vehicles should encourage the early adoption of electronic submission since it speeds the process and increases accuracy.

Motor Vehicles should assess its way of processing and reviewing information to determine if the system can reduce the manual oversight and reviews. This assessment should compare not how Motor Vehicles would like to process information, but what method is most efficient for processing information on the new system. Trying to continue to process information in a manner not compatible with the system will continue to lead to delay in processing data, inaccurate reports, and confusion between Motor Vehicles and the taxpayer.

December 1, 2003

The Honorable Mark R. Warner  
Governor of Virginia  
State Capitol  
Richmond, Virginia

The Honorable Kevin G. Miller  
Chairman, Joint Legislative Audit  
and Review Commission  
General Assembly Building  
Richmond, Virginia

### INDEPENDENT AUDITOR'S REPORT

We have audited the financial records and operations of the Department of Motor Vehicles for the year ended June 30, 2003. We conducted our audit in accordance with Government Auditing Standards, issued by the Comptroller General of the United States.

#### Audit Objectives, Scope, and Methodology

Our audit's primary objectives were to evaluate the accuracy of recording financial transactions on the Commonwealth Accounting and Reporting System and in the Department's accounting records, review the adequacy of the Department's internal control, and test compliance with applicable laws and regulations. We also reviewed the Department's corrective actions of audit findings from prior year reports.

Our audit procedures included inquiries of appropriate personnel, inspection of documents and records, and observation of the Department's operations. We also tested transactions and performed such other auditing procedures, as we considered necessary to achieve our objectives. We reviewed the overall internal accounting controls, including controls for administering compliance with applicable laws and regulations. Our review encompassed controls over the following significant cycles, classes of transactions, and account balances:

Expenditures  
Revenues  
Fixed Assets

We obtained an understanding of the relevant internal control components sufficient to plan the audit. We considered materiality and control risk in determining the nature and extent of our audit procedures. We performed audit tests to determine whether the Department's controls were adequate, had been placed in operation, and were being followed. Our audit also included tests of compliance with provisions of applicable laws and regulations.

The Department's management has responsibility for establishing and maintaining internal control and complying with applicable laws and regulations. Internal control is a process designed to provide reasonable, but not absolute, assurance regarding the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.

Our audit was more limited than would be necessary to provide assurance on internal control or to provide an opinion on overall compliance with laws and regulations. Because of inherent limitations in internal control, errors, irregularities, or noncompliance may nevertheless occur and not be detected. Also, projecting the evaluation of internal control to future periods is subject to the risk that the controls may become inadequate because of changes in conditions or that the effectiveness of the design and operation of controls may deteriorate.

#### Audit Conclusions

We found that the Department properly stated, in all material respects, the amounts recorded and reported in the Commonwealth Accounting and Reporting System and in the Department's accounting records. The Department records its financial transactions on the cash basis of accounting, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. The financial information presented in this report came directly from the Commonwealth Accounting and Reporting System,

We noted a certain matter involving internal control and its operation that we consider to be a reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of internal control that, in our judgment, could adversely affect the Department's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial records. The reportable condition is described in the subsection titled "Internal Control Finding and Recommendation." We believe that the reportable condition is not a material weakness.

The results of our tests of compliance with applicable laws and regulations disclosed no instances of noncompliance that are required to be reported under Government Auditing Standards.

The Department has not taken adequate corrective action with respect to the previously reported findings "Assess Needs and Develop Policy and Procedures over the Fuels Tax Program." Accordingly, we included this finding in the subsection entitled "Internal Control Findings and Recommendations." The Department has taken adequate corrective action with respect to the audit findings reported in the prior year that are not repeated in this report.

This report is intended for the information and use of the Governor and General Assembly, management, and the citizens of the Commonwealth of Virginia and is a public record.

#### EXIT CONFERENCE

We discussed this report with management at an exit conference held on December 9, 2003.

AUDITOR OF PUBLIC ACCOUNTS

NJG/kva  
kva:



# COMMONWEALTH of VIRGINIA

Department of Motor Vehicles

2300 West Broad Street

D. B. Smit  
Commissioner

Post Office Box 27412  
Richmond, VA 23269-0001  
866-DMV-LINE or  
800-435-5137

December 9, 2003

The Honorable Walter J. Kucharski  
Auditor of Public Accounts  
James Monroe Building  
Richmond, Virginia 23219

Dear Walt:

This letter is in response to the APA audit report for the fiscal year ending June 30, 2003. We appreciate the opportunity to respond.

Under separate cover we have provided your staff with some additional information on the one management point regarding fuels tax. We concur with the overall findings and will make this area a priority over the next 12 months.

We concur with the presentation of the remainder of the financial statements and comments.

Sincerely,

D. B. Smit

DBS:bl

Copy: The Honorable Whittington W. Clement  
The Honorable Ralph E. Davis  
William E. Landside

DEC 10 '03 PM 1:11

DEPARTMENT OF MOTOR VEHICLES  
Richmond, Virginia

Demerst B. Smit, Commissioner

J. Lynwood Butner, Deputy Commissioner

Philip Vasquez, Deputy Commissioner

John C. Christian, Controller

William E. Landsidle, Chief Financial Officer